CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

BILL ANALYSIS

Senate Bill 1983	**Senator Soto (As amended 4/10/02)**
Position:	**Sponsor (Staff recommendation)**
Proponents:	**ACSA, CalSTRS, CTA, CRTA**
Opponents:	**None known**

SUMMARY

Senate Bill 1983 makes the following minor changes to the benefit and investment programs administered by the California State Teachers' Retirement System (CalSTRS):

- Includes (1) the period of disability for selected members who received a Disability Allowance under Coverage A, and (2) up to .2 years of unused sick leave in determining eligibility for career-based enhancements to Defined Benefit (DB) Program allowances, such as single year final year compensation, the career factor and the longevity bonus.

- Allows a member receiving an allowance under Options 6 or 7 to name a new beneficiary after a member's beneficiary dies. In addition, the bill requires the Teachers' Retirement Board (Board) to submit a report to the Legislature, as specified, that evaluates existing options and makes any appropriate recommendations to change the options based on the needs of the members and their beneficiaries.

- Allows CalSTRS to acquire and develop surplus land owned by school districts through joint ventures and limited partnerships for sale to third parties and leaseback to school districts.

HISTORY

Chapter 1006, Statutes of 1998 (AB 1102—Knox) extends eligibility to receive credit at retirement for unused sick leave to members of CalSTRS DB Plan who became members on after 7/1/80, and who retire on or after 1/1/98.

Chapter 1076, Statutes of 1998 (SB 2126—Schiff), among other things, allows school districts, county offices of education and community colleges to participate in the CalSTRS credit enhancement program, under which CalSTRS issues letters of credit that enhance the value of approved debt issued by local agencies.

AB 430 (Cannella—1996) would have allowed any member who retired prior to 1/1/91 under Option 2 or 3, and whose beneficiary had died prior to 1/1/95 and no new option beneficiary had been named by the retired member, to return to the unmodified allowance. The bill was held in the Assembly.

SB 1658 (Costa—1996) would have required the Board to conduct a sample survey to determine the number of members and cost for those who retired before 1/1/91 with an Option 2 or 3 to return to the unmodified allowance if the option beneficiary died prior to 1/1/95. The Board agreed to conduct the survey without legislation. The bill was held in the Assembly.

CURRENT PRACTICE

Use of Projected Service and Unused Sick Leave to Qualify for Benefit Enhancements
The DB Program benefit formula pays an allowance equal to two percent of final compensation for each year of service at age 60. This age factor increases for members who retire after age 60, up to 2.4 percent at age 63. For members with 30 or more years of credited service, an additional 0.2 percent of final compensation per year of credited service is added. In addition, a longevity bonus is added to the monthly, unmodified retirement allowance of members who accumulate at least 30 years of service credit prior to January 1, 2011. For 30 years of service credit, a member would receive a monthly increase of $200; for 31 years, an increase of $300; for 32 years, an increase of $400.

Currently, for purposes of determining eligibility for these enhancements, credited service does not include (1) "projected service", which is defined as the sum of credited service plus the credited service that would have been earned for the school years during the which a disability allowance was payable if the member had performed creditable service during that time, (2) the amount of accumulated sick leave that has not been used at the time of retirement, (3) Golden Handshake service or (4) nonqualified service.

Modify Options 6 and 7 To Permit Members Who Pop-Up to Name a New Beneficiary and Report to the Legislature on the Efficacy of the Current Options
A member's unmodified allowance (equal to a percentage, based on the age of retirement, of final compensation, multiplied by the number of years of service credit, plus a longevity bonus, if eligible) ceases to be paid when the member dies. A member may elect to modify that allowance by electing an option, which continues to pay an allowance to a named beneficiary or beneficiaries after the member dies. The member may select from six different options. Members also may elect that option at the time the member is eligible to retire in order to provide an improved survivor benefit if the member dies before retirement.

Under Options 2 and 3, the beneficiary receives 100 percent and 50 percent, respectively, of the member's allowance at the time of death. If the beneficiary dies before the member, the member may select a new option and/or beneficiary. Options 4 and 5 pay a reduced benefit when either the member or the beneficiary dies. Options 6 and 7 pay the same percentage of the allowance paid under Options 2 and 3, respectively, but if the beneficiary dies first, the member's allowance increases, or "pops-up" to the unmodified level, and no new beneficiary can be named.

Acquire and Develop Surplus Land Owned by School Districts
Existing law requires that CalSTRS assets be held for the exclusive purposes of providing benefits to CalSTRS members. As a public pension fund, CalSTRS is not subject to the federal Employee Retirement Income Security Act (ERISA), which governs corporate pension plans.

However, CalSTRS' investment decision-making criteria are based on the "prudent expert" standard, upon which ERISA is based. The Teachers' Retirement Law (TRL) imposes additional limitations on investment transactions that directly or indirectly involve a CalSTRS member or employer. Specifically, CalSTRS may not engage in a transaction involving the sale, exchange or leasing of property, lending of money, furnishing of goods or services or transfer to a CalSTRS member if the financial consideration is less than adequate to CalSTRS.

The TRL also prohibits any acquisition of any security, real property or loan of any CalSTRS employer, even if, from CalSTRS' perspective, adequate financial consideration is given for the transaction. The California Public Employees' Retirement System (CalPERS) has no similar statutory restriction on investment activity benefiting an employer, nor are such investments entirely prohibited under ERISA. This prohibition on investments concerning employers excludes a universe of potentially prudent investment opportunities in school districts and community college districts that could add value to the portfolio and the membership.

DISCUSSION

Use of Projected Service and Unused Sick Leave to Qualify for Benefit Enhancements
Under the bill, projected service, and up to .2 years of unused sick leave (equal to 36 working days for a member with a 180-day annual contract), would be used in determining eligibility for benefit enhancements (such as the career factor, highest year final compensation and the longevity bonus) that are based on accruing specified levels of service credit. The use of projected service would apply only to members who received a disability allowance and then returned to active service, for a minimum of one year, before retiring. The purpose for establishing a minimum service requirement is to prevent a person from returning to work for a de minimis period of time, without any real change in the person's disability status, simply for the purpose of receiving the enhanced benefit.

CalSTRS estimates that about 120 members would qualify for the enhanced benefits if projected service were counted., The number of members affected by the proposal to count a portion of unused sick leave in determining eligibility for benefit enhancements is expected to be small because this change would only apply to members who were within .2 years of qualifying for a benefit enhancement. The Board is currently sponsoring the proposal to count projected service towards qualifying for benefit enhancements.

The benefit enhancements were intended to reward members who provide an extended career. Using projected service when a person returns to work recognizes the likelihood that the person would have earned the benefit enhancements if the person had not become disabled. Similarly, members who have unused sick leave perform more service than do members who use up their sick leave, and counting at least a portion of that unused sick leave would reward member for providing that additional service.

Modify Options 6 and 7 To Permit Members Who Pop-Up to Name a New Beneficiary and Report to the Legislature on the Efficacy of the Options

This bill modifies Options 6 and 7 to permit members who pop-up to the unmodified allowance to name a new beneficiary. Currently, a member may not name a new option beneficiary under Options 6 and 7 after the beneficiary dies. This change would be consistent with choices available to members under Options 2, 3, 4 and 5, which allow a member to choose a new option beneficiary after the death of the original beneficiary.

The bill also requires the Board to report to Legislature on or before January 1 of an unspecified year to evaluate the existing options and to make any appropriate recommendations to change the options based on the needs of the members and beneficiaries. The report will consider changes to the current option structure and will analyze changes needed to provide economic security of beneficiaries while at the same time reducing the complexity of the current options. There are seven options available to members (including the unmodified allowance), each of which has different effects on the allowance of the member and his or her beneficiaries. CalSTRS has found that the number of options offered confuses members, which makes it difficult for members to determine which option best suits their individual circumstances. Under the bill, CalSTRS would evaluate alternative option choices that enable the member to have nearly equivalent choices without the same amount of confusion.

Acquire and Develop Surplus Land Owned by School Districts

SB 1983 allows CalSTRS to make investments related to the acquisition, planning, and development of surplus land owned by CalSTRS employers. It also requires that any such transaction satisfy the general fiduciary standards established in the TRL and Section 503 of the Internal Revenue Code, which prohibits the system from acquiring any security, real property or loan from an employer for more than adequate consideration. The Board is currently sponsoring this proposal.

This proposal conforms the restriction on investments in property owned by employers to those imposed on transactions concerning members, as well as standards imposed on CalPERS and corporate pensions under ERISA. Under the bill, Board members and other statutory fiduciaries for the System would be required to exercise the same care, skill, prudence and diligence for investments in employing agencies as when investing in other securities, as outlined in existing law, the Investments Committee Charter, and the Investment Management Plan.

Under current law, prudent investment opportunities involving surplus land held by school districts and community college districts that could add value to the portfolio and the membership will be lost. The System would be able to participate in limited partnerships and joint ventures to acquire, develop and sell these properties, or, lease back to the districts themselves.

FISCAL IMPACT

Benefit Program Costs –
Unused sick leave credit
The System Actuary estimates that the total present value cost of authorizing the use of up to .20 years of unused sick leave to qualify for enhanced benefits would be $58 million. The annual revenue needed to support this proposal is $5 million, beginning in fiscal year 2003-04.

Projected service credit
Allowing the use of projected service credit to count towards enhanced benefits would have a total cost of approximately $42 million. In addition, the annual revenue required to support this proposal over a 30-year period is $4 million, beginning in 2003-04.

Modify Options 6 and 7
The total costs of authorizing members to choose a new beneficiary after they pop-up to an unmodified allowance under Options 6 and 7 is expected to be minor.

Administrative Costs – The cost of the required changes to the System's corporate database is expected to exceed $150,000.

RECOMMENDATION

Sponsor. The Board is already sponsoring the provisions concerning the use of projected service in benefit enhancements and investments in employer property. This bill is consistent with the Board's previous actions to enhance the services provided to CalSTRS members.